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# The impact of kwacha depreciation on small and micro enterprises (SMEs): Case study: SMEs in the central business district (CBD) of Lusaka city

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**Abstract**
This report assessed the economic impact that the depreciation of the Zambian currency has had on the Micro and Small Scale enterprises (SMEs) in the Lusaka central business district (CBD). The study investigated the potential business impact of the depreciation on SMEs during the period 2012 and 2017.
One of the objectives was to assess short- and medium effects on SMEs operating from the Lusaka's CBD. The research was carried out in Lusaka's CBD area using stratified and random sampling. The methodology consisted of business houses survey in which questionnaires were distributed to respondents. The methodology of the direct assessment approach used direct loss by which it estimated the cost attributed to the loss of value by the kwacha. The direct assessment method is an economic appraisal tool that estimates the cost of the devaluation of the kwacha.
This report was organized in three main sections. The first section analyzed the potential economic impact of the loss of value by the currency on Micro and small-scale enterprises. Secondly, uncertainty that surrounded the timing of power cuts and the damage done by the unplanned electricity cuts.
The negative impact on SMEs was greater in the short term than in the medium or long term. However, there might be long-term consequences of businesses being forced to adjust to a sharp decline in the value of the kwacha. Examples included the reduction in sales, Inflation, cost of raw materials and imported products, increased transportation costs, and job cuts by the direct assessment.
The paper presents the analysis of the direct costs incurred by SMEs that went beyond inflation and increased cost of imported products for resell. In addition to reduced sales, other direct costs were the negative impact on transportation costs and complaints from customers with regard to a sharp increase in prices of products.
The exact impact was a shift in prices of imported goods, rise in inflation and an increase in the cost of airtime and internet data bundles. Respondents gave their solutions to the current depreciation of the kwacha such as diversifying the economy into finished product export and the exportation of finished products. Trading directly with China Yuan (ZMK/YUAN) exchange rate, other than by first buying the US Dollar with Zambian kwacha and later use the US Dollar to purchase the Yuan.

**Keywords:** depreciation, diversification, exchange rate, small to medium enterprises (SMEs), central business district (CBD)

## Introduction

There had been excessive depreciation of the Zambian kwacha against United States Dollar over the last five years and following excessive depreciation of the Zambian kwacha (ZMK) against the US Dollar. Projections for the price of US dollar in terms of the Zambian Kwacha were that the Zambian kwacha was likely to depreciate further against the US Dollar owing to the fact that domestic production, especially in the mining sector whose revenue contributes heavily to stabilizing the Zambia kwacha.

Furthermore, the Zambia government had been running million US Dollar projects in the construction of schools health posts and road infrastructure and most of the inputs and labor were imported from China. However, the medium of exchange for importing these inputs was US Dollar. This compounded with reduced foreign earnings from the mining sector might had contributed to putting more pressure on the US dollar leading to further deprecation of the Zambia. Since China had become one of the major trading partners of the Zambian economy with most of the finished and intermediates goods being traded in the Zambian market being imported from China. (Path Graig, 2015) [8].

The higher fiscal deficit had led to approximately attacks on currency. In case of high deficit, government might use foreign currency reserve to finance the deficit (Elwell, 2012) [1]. This led to lowering of reserves and if there was speculation of currency, the government might not have adequate reserve to protect the fixed value of currency. This prompted the government to devalue the currency. Though fiscal deficit had no direct bearing on foreign markets, it played a role in crisis.

Demand and supply rule means if there was more demand of dollars in the currency market and was not adequately matched by the supply, other things remaining equal, the kwacha price of dollar would go up or the Kwacha will depreciate. Importers requiring more dollars to pay for their imports might create demand for dollars. On the other hand, exporters bringing in more dollars from their revenues created supply.

Great volatility in stock market also regarded as another reason for the currency devaluation. Our equity market was volatile for some time (Wuhan, 2015) [10]. Equity means the investments in Zambian companies made by foreign institutional investors. But as the Us federal Bank start scaling back the monetary stimulus that had kept interest rate ultras low and sent investors to developed market in search for high return.

Improving the strength of the US economy and dollar gaining strength against other currencies was considered as another reason for the crisis. That was Reserve Banks of Euro zone and Japan printed excessive money due to which their currency was being devalued. On the other hand, US Federal bank had shown signs to end their stimulus. Stimulus was a plan by central bank to counter a weak economy, by taking various actions like lowering interest rates, increase government spending, and quantitative easing to mention but a few. This side effect included weakening currency hence helped to make US Dollar stronger against other major currencies. (Deepa Divakaran. N, 2014) [9].

Diverging central bank policy had created a perfect launch pad for the dollar to move higher, particularly against the euro. The recent strengthening of the US dollar globally was also a reflection of the demand for US dollars relative to other currencies including the Zambian Kwacha.

Jesuit Centre for Theological Reflections (JCTR) in 2014 observed that the increased prices and demand for oil and other petroleum was another reason for Zambian Kwacha fall. Zambia had to import bulk of its oil requirements to satisfy its local demand, which was increasing every quarter of the year. The domestic demand for oil was increasing which caused the price of the oil to increase in the international market. The demand for dollar increased, as we had to make payments to our suppliers in dollars. (Source: JCTR, 2014)

This increase in demand for dollar weakened the kwacha. 55% of the Zambia's oil import was used for transportation of goods and people and 50%of that or 27% of the total is used for transporting the many Zambians who owned cars and were into transportation business. Increase in the quantity of oil import into Zambia, a further pressure was imposed on the demand of dollars to pay their suppliers from whom oil and other petroleum products were imported. This increase in demand for dollars depreciated the kwacha further. (Source: JCTR, 2014)

Withdrawal by investors affected the Kwacha to decline in value. The economic slowdown of many industries, in the Zambian environment, the market's weakness for the government to implement public policies were increasingly disappointed. Global mining giants like Glencore and First Quantum Mineral Limited decided to withdraw and partial withdraw respectively their investments. (Source: http://www.zda.org.zm)

Higher inflation Zambian economy was experiencing higher inflation, which would decrease purchasing power of kwacha against other currencies. This would lead to kwacha depreciation. Zambia's money supply grew and this essentially meant that more kwachas were printed than required which caused a rise in inflation.

High fiscal deficit could be regarded as another reason for this crisis. It was the difference between Government receipt and Government spending. Between 2012 and 2016, the executive had being involved in a lot of unbudgeted for activities such as the creation of provinces and districts, the constitutional making process, the parliamentary by-elections, creation of ministries and departments, foreign trips and infrastructure projects.

**Statement of the problem**

Zambia was mostly a commodity exporting based economy with many business people importing most of their tradable for sale. Hence, when the kwacha depreciated the incentive for local business people to raise their prices was high. There was a general view among the public that a "strong" kwacha represented a strong economy. This view while having its merits was flawed for several reasons. (Kampamba Shula, 2015) [16].

Firstly, most of Zambia's exports were copper; hence, a strong Kwacha usually meant that copper prices were sufficiently high to sustain favorable exchange earnings. Secondly, this view undermined the Government's effort to diversify the economy away from copper.

In Zambia outside the minerals sector, exported output was low, imported inputs high, and foreign currency debt low. These combined to create a strong probability that a depreciation of the currency would generate net disincentives to agricultural and manufacturing producers in Zambia. (Fundumu, 2015) [2] It was for this reason that many in the government and the private sector argued in favor of a "strong" and appreciating currency, as a necessary support for diversification into agriculture and manufacturing.

If an economy were at less than full utilization of resources, an appreciation would tend to reduce aggregate demand. The demand reducing effect came through the cheapening of imports, which would in the medium term lower domestic production of importable. For a non-diversified developing country, Zambia being an obvious case, nominal appreciation should result from long run increases in the productivity of exportable combined with declining structural inflation.

Copper dominated the external trade of Zambia, and the nominal exchange rate had little short-term impact on metal production or export (ZDA, 2014). Zambia did not export copper because of comparative advantage in which relative factor scarcities determined comparative costs. In the case of Zambia, copper exports resulted from a specific natural endowment. In the absence of policy intervention by the Zambian government or Bank of Zambia, the level of the Kwacha responded to domestic copper production and the international price, on the one hand, and the international prices and domestic demand for major imports.

In 2014 the Kwacha depreciated by 14% against the US dollar, whilst over the first quarter of 2015 it has depreciated by 15.6%. By July 2016, the Kwacha had depreciated by 50%. (EAZ, 2016)

On 15th April, 2011, the South African rand was selling at K 0.6, the European Union's Euro was at K 6.5, the Botswana pula was selling at K0.9, while the British pound was selling at K7.3 and the United States dollar was buying at K4.3 and selling at K4.5 (Source: www.boz.zm) 30th March,2016, the United States dollar ($) was selling at K11.24, British pound buying at K16.18 and selling at K16.22, The European Union currency Euro was selling at K12.78 and the South African Rand was selling at K0.76. (Source: www.boz.zm)

On 20th August, 2016, the South African rand was selling at K11.35, the European Union's Euro was at K 12.54,the Botswana pula was selling at K1.5,while the British pound was selling at K13.2 and the United States dollar was buying at K11.1 and selling at K11.3 (Source: www.boz.zm)

The supply of foreign exchange by the mining sector had recently fallen relative to demand, and that could not be purely explained by the reduction in domestic production because we had seen higher mining sector exports in 2014 and a serious reduction in 2016 owed to the slowed down of the Chinese economy.

The world copper price was the major short-term influence on the level of domestic production, and that was the most important determinant of exports (Elwell, 2013). This production required imported inputs, and the copper sector trade balance represented by far the largest component of the overall trade balance. The foreign exchange market policies of the mining companies directly impacted on flow of export revenue into the national economy.

Other issues had been raised with respect to mining tax policy, royalty's payable, tax refunds and value added tax, which also impacted on sentiment in the market.

The deterioration in the external sector continued in the fourth quarter of 2014 and the situation seemed to be worsening at the beginning of 2015 (Shruti Patel, 2015). Overall balance of payments deficit widened driven by unfavorable performance in both the current and financial accounts.

The decline in export earnings was mainly explained by a contraction of 7.8% in copper export earnings following a decline in export volumes and averaged realized copper prices. The current account in 2014 registered a deficit of US $431 million, when compared to a deficit of US $284 million in 2013. Non-traditional exports fell from of US $3.6 billion in 2013 to an estimated US $2.2 billion in 2014 a drop of 39%. (SOURCE: BOZ, 2015)

Wider Current Account Deficit (CAD) could be regarded as another reason for currency fall. A current account deficit occurred when a country was importing more goods and services than that was exporting. In other words, Zambia was importing more than it is exporting. (Action Aid, 2015)

This wider current account deficit usually created demand for dollar which resulted in kwacha depreciation. The deficit could be bridged either by using country's forex reserves or from capital inflows through the Zambia Development Centre. It had also taken measures to boost exports, taking advantage of depreciating Kwacha. (ZDC, 2014)

**Research objectives**

The general objective of this study is to evaluate the effects of the loss of value by the kwacha on Micro and Small Scale Enterprises in Lusaka's Central Business District.

The general objective of this research was to:

- Assess the overall impact on business by the depreciation of the kwacha since almost all the inputs and the goods for resale in businesses were imported.
- The specific objectives of this study included:
- To assess the forms of businesses affected as a result of the devaluation of the Kwacha
- To obtain information from SMIs on the impact of kwacha's devaluation on sharp price increases of goods and services.
- To appraise the level of job cuts experienced by these firms because of the kwacha devaluation.

## Chapter 2: literature review

### Global perspective

Graig K. Elwell specialist in Macroeconomic policy, February 23 2012 [1] discussed 'The depreciating dollar: Economic effects and Policy Response; In this report to congress a trend depreciation of the dollar since 2002 raises concern among some in Congress and the public that the dollar's decline is a symptom of broader economic problems, such as a weak economic recovery, rising public debt, and a diminished standing in the global economy. However, a falling currency is not always a problem, but possibly an element of economic adjustments that are, on balance, beneficial to the economy. A depreciating currency could affect several aspects of U.S. economic performance. Possible effects include increased net exports, decreased international purchasing power, rising commodity prices, and upward pressure on interest rates; if the trend is sustained, the United states may also experience a reduction of external debt, possible undermining of the dollar's reserve currency status, and an elevated risk of a dollar crisis. The exchange rate is not a variable that is easily addressed by changes in legislative policy. Nevertheless, although usually not the primary target, the dollar's international value can be affected by decisions made on policy issues facing the 112th Congress, including decisions related to generating jobs, raising the debt limit, reducing the budget deficit, and stabilizing the growth of the federal government's long-term debt. In addition, monetary policy actions by the Federal Reserve, over which Congress has oversight responsibilities, can affect the dollar.

To give Congress the economic context in which to view the dollar's recent and prospective movement, this report analyzes the evolution of the exchange rate since its peak in 2002. It examines several factors that are likely to influence the dollar's medium-term path, what effects a depreciating dollar could have on the economy, and how alternative policy measures that could be taken by the Federal Reserve, the Treasury, and the 112th Congress might influence the dollar's path Graig K. Elwell specialist in Macroeconomic policy, February 23 2015 discussed 'The depreciating dollar: Economic effects and Policy Response'.

Deepa Divakaran.N a Research Scholar at Mahatma Gandhi University Kottayam and Kerala, India Dr. G.S. Gireesh kumar an Associate Professor & Research Guide at Nirmala College Muvattupuzha, Kerala, India published an article in the IRACST – International Journal of Commerce, Business and Management (IJCBM), ISSN: 2319–2828 Vol. 3, No. 1 in February 2014, titled Currency depreciation - causes and its impact on Indian economy where they discussed that the Rupee depreciation has been the hot subject in current economic scenario. We are experiencing a tough time with rupee depreciation every day. Current economic context created anxious moments to various industrial sectors in India. On 1st Dec, 2013 the value of Indian rupee stood at 62.44. The experts in the field perceived the situation in different manners. Some considered it as highly depressed and threatening environment; some others considered it as an opportunity in disguise. There are various positive and negative impacts which are being predicted by experts in the fields. Rupee depreciation, no doubt it will affect upper and lower sectors of the economy. This spectacular decline of rupee value will loss India's confidence in its growth prospect too. RBI and government is taking various measures with the objective of making a stabilized floor for Indian rupee. Mr. Raguram Rajan, RBI Governor, has shown reflections of hope in the present crisis. This paper tries to explore the causes and impact of rupee depreciation on the Indian economy and tries to review various measures taken by RBI and Government to get over the present crisis.

Bilal Ahmed, Xianming Wu of the School of Economics and Management, Wuhan University, Wuhan, China, Zia Ur Rehman of the Department of Economics, Gomal University, Pakistan and Ilyas Ahmed of the School of Accounting, Zhongnan University of Economics & Law, Wuhan, China, European Journal of Business and Management published an online paper on www.iiste.org ISSN 2222-1905 (Paper) ISSN 2222-2839 (Online) Vol.7, No.32, 2015, titled The Impact of Exchange Rate Depreciation on Economic and Business Growth in Pakistan and they reported that depreciation remained a common factor in Pakistani economic history in different regimes, which affected different economic variables, especially the growth and business sector. We have linked depreciation with economic and business growth for Pakistan in this paper. Using time series data from 1976 to 2010 and employing co integration followed by the Error Correction Model, we find that exchange rate depreciation has adversely affected growth in the business sector, notably Investment and FDI, while net export has a positive association with the exchange rate. All these findings reveal that depreciation is not a good practice because it has negative impact for growth in the business sector. The present scenario of the flexible exchange rate does not allow the corresponding authorities to set desirable exchange rates; however, the government must reinforce the real sector in order to ensure a stable exchange rate and hence macroeconomic stability.

**Regional perspective**

Ilyas Ahmed, B Imimole, A Enoma, from the department of Economics at Ambrose Alli University, Ekpoma, Nigeria, July 30, 2011 wrote a research paper called Exchange Rate Depreciation and Inflation in Nigeria (1986-2008) in this research paper he examined the impact of exchange rate depreciation on inflation in Nigeria for the period 1986–2008, using Auto Regressive Distributed Lag (ARDL) Co integration Procedure. The research found that exchange rate depreciation, money supply and real gross domestic product are the main determinants of inflation in Nigeria, and that Naira depreciation is positive, and has significant long-run effect on inflation in Nigeria. This implied that exchange rate depreciation could bring about an increase in inflation rate in Nigeria. The paper also found that inflationary rate in Nigeria has a lagged cumulative effect. The research paper concluded that although Naira depreciation was relevant in ensuring an improvement in the production of exportable commodities, it must not be relied upon as a potent measure for controlling inflation in Nigeria. The paper recommended the need for policy-makers to employ exchange rate depreciation as a measure to compliment other macro-economic policies to stabilize the volatile inflationary rate in Nigeria.

Nabil Ben Ltaifa, Stella Kaendera, and Shiv Dixit (2009) [13] sponsored by INTERNATIONAL MONETARY FUND wrote a book titled Impact of the Global Financial Crisis on Exchange Rates and Policies in Sub-Saharan Africa. In this book, they indicated that the currencies of many sub-Saharan African countries, like those of many emerging and developing economies, suffered large depreciations with the onset of the global financial crisis. Collapsing trade and financial flows led to substantial balance of payments gaps, triggering fast depreciations and higher exchange rate volatility, beginning in mid-2008. The exchange rate losses varied largely commensurate with the extent and nature of each country's exposure to trade and global financial markets. The new external environment raises challenges for both floating and managed currencies. Countries with managed exchange rates have faced costs in leaning against exchange rate movements resulting in wider margins in the appreciation of their real exchange rates. Such an outcome could harm competitiveness and undermine long-term sustainability if their real effective exchange rates significantly deviate from their equilibrium levels. Countries with floating currencies had faced increasing exchange rate and price volatility, which could also deter long-term investment.

Eme O. Akpan1 and Johnson A. Atan wrote an article in the CBN Journal of Applied Statistics Vol. 2 No.2 titled Effects of Exchange Rate Movements On Economic Growth in Nigeria and in this study investigated the effect of exchange rate movements on real output growth in Nigeria. Based on quarterly series for the period 1986 to 2010, the paper examined the possible direct and indirect relationship between exchange rates and GDP growth. The relationship is derived in two ways using a simultaneous equations model within a fully specified (but small) macroeconomic model. A Generalized Method of Moments (GMM) technique was explored. The estimation results suggest that there is no evidence of a strong direct relationship between changes in exchange rate and output growth. Rather, Nigeria's economic growth had been directly affected by monetary variables. These factors had tended to sustain a pattern of real exchange rate, which had been unfavorable for growth. The conclusion was that improvements in exchange rate management were necessary but not adequate to revive the Nigerian economy. A broad program of economic reform was required to complement the exchange rate policy adopted.

**Zambian perspective**

The exchange rate of the dollar is largely determined by the market the supply and demand for dollars in global foreign exchange markets associated with the buying and selling of dollar denominated goods, services, and assets (e.g., stocks, bonds, real property) on global markets. In most circumstances, however, international asset-market transactions tended to be dominant, with the size and strength of inflows and outflows of capital ultimately determining whether the exchange rate appreciates or depreciates. A variety of factors can influence the size and direction of cross-border asset flows. Of principal importance are the likely rate of return on the asset, investor expectations about a currency's future path, the size and liquidity of the country's asset markets, the need for currency diversification in international investors' portfolios, changes in the official holdings of foreign exchange reserves by central banks, and the need for and location of investment safe havens. All of these factors could themselves be influenced by economic policy choices. Caleb M Fundanga; 9th July, 2009, Lusaka; Global Financial and Economic crisis and its effect on the Zambian economy.

Kampamba Shula, 2015 [16], wrote The Inevitable Depreciation of the Zambian Kwacha; causes, consequences and policy. In his paper he wrote that Zambia is mostly a commodity exporting based economy with a lot of business people importing most of their tradable for sale. Hence when the kwacha depreciates the incentive for local business people to raise their prices is high. There was a general view among the public that a "strong" kwacha represents a strong economy. This view while having its merits was flawed for several reasons. Firstly most of Zambia's exports are copper; hence a strong Kwacha usually means that copper prices are sufficiently high to sustain favorable exchange earnings. Secondly this view undermines the Government's effort to diversify the economy away from copper.

Humphrey Fundumu a lecturer, Economics Department, School of business, Copperbelt University, Kitwe Zambia's correspondence in the International Journal of Applied Research of 2015 where he discussed the 'Excessive depreciation of the Zambian Kwacha against the US Dollar; firms, households and government; What is the way forward? The main aim of the study was to explore possibilities of trading directly with ZMK/YUAN as the Zambian firms and household's trade with China. The study employed the Multivariate co integration test and Vector autoregressive (VAR) model to analyze the data. The findings indicated that exchange rate variables namely ZMKYUAN, ZMKUSD, ZMKRAND and ZMKFRANC do not have long run relationship among each other in the system of equations. Furthermore, short run results in the VAR system also showed that ZMKUSD and ZMKYUAN do not have short run significant effect on each other. These findings indicate that changes in ZMKUSD do not have long run and short run effect on ZMKYUAN. The implication for Zambian firms and households is that they can avoid cost of appreciation of US Dollar by trading directly with ZMK/YUAN rather than trading with ZMKUSD and later with YUAN/USD as they import goods from China. Therefore, this called for government to liberalise the transactions in ZMK/YUAN.

Bank of Zambia, Direction of trade report, fourth quarter, Lusaka, Zambia, 2009.

Bank of Zambia, Direction of trade report, third quarter, Lusaka, Zambia, 2011

Allan C.K Mukungungu, Venkatech Seshekami, John Weeks and Shruti Patel with support from the United Nations Development Programme wrote a book titled 'Kwacha Appreciation 2005 - 2006;Implication For The Zambian Economy' in this book that indicated that starting in the second half of 2005 through September 2006, the Zambian Kwacha appreciated dramatically against all the major currencies. This sudden appreciation generated debate as to the cause and impact it had on the economy. The exporters in the manufacturing sector feared the impact of the appreciation on Zambia's international competitiveness. The farming groups expressed alarm about its negative impact on agricultural profitability and employment. Donors and lenders were concerned about the falling value of development assistance. Furthermore, another important factor was the impact of the Kwacha appreciation on fiscal space and the capacity to implement the Fifth National Development Plan, which focuses on increasing growth, reducing poverty and achieving the Millennium Development Goals. In view of the foregoing, this Report investigates the impact of the exchange rate appreciation on the Zambian economy to determine whether a policy response is required. The Report specifically looks at the impact of the Kwacha appreciation on trade revenue, Official Development Assistance (ODA) and debt repayments and servicing. The findings of the study show a loss of US$ 197 million on trade and US$ 218 million on ODA but a gain of US$ 262 million on debt. This however, results in a net negative effect (loss) of US$ 154 million to the Zambian economy even when the study was extended from the first quarter of 2003 to the second quarter of 2006. Furthermore, the Report stated that for Zambia to achieve faster growth, economic diversification and poverty reduction, it needed to have a development-focused exchange rate policy, in particular, a stable exchange rate, which will encourage private sector development as well as planning for various stakeholders in the economy. The United Nations Development Programmed hoped that the Report would be useful for the Government, stakeholders in the private sector and the cooperating partners.

Monetary and Financial Sector Developments Overall, inflation and interest rates during the period 2002 to 2005 assumed a declining trend. The exchange rate of the Kwacha against the United States Dollar was relatively stable. The Kwacha began to appreciate in 2005. Credit provision to the private sector in real terms also increased. Inflation, measured by the Consumer Price Index (CPI) fell from 26.7 percent at the end of 2002 to 15.9 percent at the end of 2005. Nonetheless, the inflation outcome remained short of the PRSP target of reaching single digit inflation by 2004. The inability to rapidly bring down inflation was largely due to excessive growth in money supply particularly in 2002 and 2004 when money supply growth was above 30 percent. The failure to control growth in money supply was, in part, a result of excessive government borrowing from the banking system, which was caused by shortfalls in donor budgetary support and expenditure overruns especially in 2002 and 2003. In addition to excessive government borrowing, effective implementation of monetary policy was constrained by the limited scope of effective financial instruments, undeveloped secondary markets, and the lack of market makers and a well-articulated code of conduct in the securities market. Republic of Zambia, Fifth National Development Plan,2006- 2010 December 2006 titled Broad based wealth and job creation through citizenry participation and technological advancement Annual inflation was much lower, averaging 11.3 percent as compared to 20 percent during the PRSP/TNDP period. This reduction was, however, below the FNDP target of single digit inflation, largely due to the adverse effects of crude oil prices over the 2006/2007 period and the global economic recession over the2008/2009 period. With regard to lending rates, these showed a declining trend during the FNDP period. The annual average commercial bank lending interest rates, though still high, declined to 27.3 percent from 46.2 percent during the PRSP/TNDP period. The high levels of lending rates and the limited availability of long-term finance remained the major constraints to growth, particularly for small to medium-scale enterprises.

The exchange rate of the Zambian Kwacha against major currencies steadily appreciated during the FNDP period. This was mainly because of improved Terms of Trade buoyed by high copper prices and output and large capital portfolio and investment inflows. The external position, however, continued to be characterized by the dominance of copper that accounted for an annual average of 77 percent of exports during the FNDP period, up from an annual average of 61 percent during the 2002-2005 period. This over-dependence on copper makes the country vulnerable to shifts in its demand and prices and has had a major influence on the exchange rate in the recent years. Republic of Zambia. SIXTH NATIONAL DEVELOPMENT PLAN 2011 – 2015, Titled “SUSTAINED ECONOMIC GROWTH AND POVERTY REDUCTION”

Monetary and Financial Sector Developments Overall, inflation and interest rates during the period 2002 to 2005 assumed a declining trend. The exchange rate of the Kwacha against the United States Dollar was relatively stable. The Kwacha began to appreciate in 2005. Credit provision to the private sector in real terms also increased. Inflation, measured by the Consumer Price Index (CPI) fell from 26.7 percent at the end of 2002 to 15.9 percent at the end of 2005. Nonetheless, the inflation outcome remained short of the PRSP target of reaching single digit inflation by 2004. The inability to rapidly bring down inflation was largely due to excessive growth in money supply particularly in 2002 and 2004 when money supply growth was above 30 percent. The failure to control growth in money supply was, in part, a result of excessive government borrowing from the banking system, which was caused by shortfalls in donor budgetary support and expenditure overruns especially in 2002 and 2003. In addition to excessive government borrowing, effective implementation of monetary policy was constrained by the limited scope of effective financial instruments, undeveloped secondary markets, and the lack of market makers and a well-articulated code of conduct in the securities market. Republic of Zambia, Fifth National Development Plan, 2006 - 2010 December 2006 titled Broad based wealth and job creation through citizenry participation and technological advancement.

**Methodology**

This study is a causal study deploying a mixed method approach for the gathering and analysis of data. 50 formed the population for the study, representing the total number of SMEs within the industrial area, which use electrical power as core resource for their businesses. A multi-sampling method was used to arrive at the study sample.

A self-administered questionnaire was used to collect primary data from 50 SMEs. Because the questionnaire was interviewer- administered, all 50 were retrieved signifying a success rate of 100%. SPSS (version 17) was used to analyze the data. Associations between the power outages and various profitability ratios were examined and a correlational analysis was used to analyze the data collected.

This study adopted a survey research design, to have a comprehensive overview of the variables under examination. In this study, Small and Medium Enterprises Performance such as: damage to equipment and machinery, complaints from customers, growth, and profit margin and so on.

Primary source of data collection was used. Four (4) point Likert scales (ranging from 1: strongly disagreed, 2: disagreed, 3: agreed and 4: strongly agreed), were used to measure responses from respondent. The choice of four Likert scale was borne out of the fact that owner or authority of the enterprises were contacted, since they are better informants of the effects of environmental factors on firms performance.

50 questionnaires were distributed. To measure validity of the study instrument, face and content validity methods was used; while test-retest method were used to ensure internal consistency (reliability).

**Sampling frame and techniques**

This is the part that explains the procedures or methods by which respondents (sample) for the study are selected from the population. It is most fundamental to the conduct of the research and interpretation of the research results. In order to best answer the research questions and achieve objectives, the researcher randomly selected homogeneous micro and small enterprises (MSEs) from Ndola’s Industrial area.

These five homogenous MSEs were welding, printing presses, grinding mills, hair salons and barbering salons. They were selected because of their heavy dependence on electricity in order to operate efficiently and effectively. The industrial area was chosen because of the high concentration of selected MSEs within the city.

From the selected homogeneous MSEs, the researcher judgmentally selected 50 respondents who were the business owners as the sample size. The method used to determine the sample size was adopted because the selected businesses were from the formal and non-formal sectors and so was difficult to determine the actual population size.

Though the five selected homogeneous MSEs and the sample size may not be true representation of the population, they have been selected as prototype of MSEs in the area to achieve objectives of the study.

In addition, the random sampling method was used to locate respondents for the study. The random sampling method was deemed appropriate because, the total members of the desired sample were not difficult to identify the researcher managed locate other similar respondents till the sample size for all homogeneous MSEs was achieved.

**Chapter 4: presentation, analysis and discussion of data**
**Introduction**

The data collection for this study was done basically through the usage of questionnaire. The researcher targeted the SMEs of Lusaka's central business district (CBD) and randomly distributed the questionnaires among them. Out of the 50 questionnaires circulated, almost 85% were returned representing a good response rate, which was deemed impressive considering the short time given to these respondents. A higher response rate would have been preferred, but there were many reasons for the percentage achieved. Two of the most crucial reasons were:

Some of the SMEs were reluctant in answering the questions because they thought the information they will provide will one way or the other fall in the hands of the tax authorities despite the assurance given in writing that all information given would be treated confidentially. Others also complained about the time given them to provide answers to the questions. According to them, it was too short and as a result their inability to complete answering the questions

In spite of these problems, the response rate of 85% for the purpose of this study is quite good.

Below are the presentations of the details of the responses.

All the respondents were SMEs located in the CBD of Lusaka and in one way of another had experienced the impact on the decline of the value of kwacha.

**Table 1:** Form of business involved in.

| Form of business | Frequency | Percent (%) |
|---|---|---|
| Computer repairs | 2 | 4 |
| Education | 7 | 14 |
| Financial services | 3 | 6 |
| Health care services | 4 | 8 |
| Internet café | 2 | 4 |
| Music and movies | 2 | 4 |
| Phone accessories | 5 | 10 |
| Phone repairs | 1 | 2 |
| Printing and photocopying | 4 | 8 |
| Retailing | 20 | 40 |
| Total | 50 | 100 |

**Source: primary data**

As can be seen from table I, the bulk of the respondents SMEs are registered are in retailing and most of the products they trade in are imported. They purchase from Dubai, South Africa and China and the medium of exchange is the United States Dollar. This entails if the dollar appreciate against the Zambian Kwacha then business becomes hard.

Retailers accounted for 20 out of 50 respondents, representing 40%. None of the respondents was Public Limited Liability Company. Seven respondents, representing 14% were in education and this represented tertiary and skills.

For foreign tertiary education, which do these offer, institution had become costlier. Students who were studying and examining bodies were foreign for instance CIMA, ACCA, ABE, ABMA, Cambridge to mention a few became very expensive owing to depreciating kwacha. Expenses incurred towards the university and college fee as well as tuition fees shoot up, thereby spelling a huge burden on the students.

The remaining 10% of the respondents SMEs were dealing in phone accessories. These phone accessories were imported in dollars and the loss of value by the kwacha entailed having more kwachas to purchase theses accessories. Most of them were ordered from China and theses entrepreneurs had to first convert the kwacha into the US dollar then later into Chinese Yen.

These SMEs surveyed cut across the various sector of the Lusaka's CBD economy such as computer repairers, printing and photocopying and chemists in the health care category were using imported inputs and imported goods for resell as shown from table (I) and (II) below.

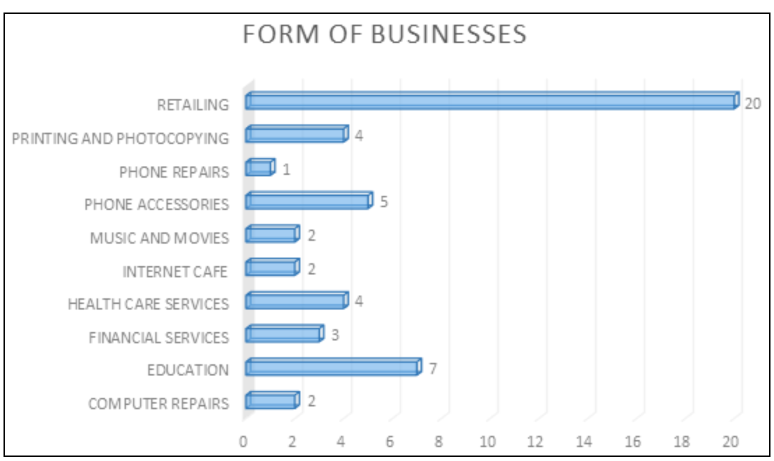


**Fig 1:** Form of business

**Source: primary data**

It is a general knowledge that SMEs cut across the various sector of an economy, hence the 68% responses received were fairly spread across a wide range of the Central business district's economy with the most concentration centered in the retail trading sector. This sector alone accounted for 40% of the total responses as can be seen from table II.

The printing and photocopying sector accounted for four respondents, representing 8%. The printing cartridges and tonner, paper and spare parts for their equipment were imported from China and South Africa thus with the devaluation their businesses were adversely affected.

Financial Services had three respondents representing a 10%.The increase in price of goods because of devaluation had decreased the total money in circulation. Devaluation pushed the interest rate up wards and decreased the aggregate demand for the financial services by SMEs and the public. Affect sMEs in the CBD that used bank loan for trade and operations who were the cliental of this sector were because of the increase in the interest rate or the cost of borrowing.

For countries that borrow money like Zambia and were highly in debt, the increase in interest rate together with devaluation of currency made the situations even worse as the cost of money increased.

Health services or chemists reported 4 or 8% representation and the internet cafes accounted for 2 or 4%. For all intent and purposes, apart from the Agricultural sector, all the key sectors of the CBD were captured in the study. With the drug stores most of the products they stocked were mostly imported from India and the US dollar was the main medium of exchange.

**Table 2:** Reduced size of the workforce (job losses)

| | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|
| Moderate | 20 | 40.0 | 40.0 | 40.0 |
| Low | 30 | 60.0 | 60.0 | 100.0 |
| Total | 50 | 100.0 | 100.0 | |

**Source: primary data**

From the above table it could be observed that 20 (40%) of the respondents were of the opinion that depreciation of kwacha had a moderate impact on job losses.

Whiles 30 (60%) strongly disagreed that the devaluation of the kwacha had any impact on the reduction of jobs.

From the table above, it can also been observed that 30 (60%) of the respondents strongly agreed that their businesses would had not experienced job losses because of kwacha devaluation.

Higher prices will raise costs directly especially since many imports are intermediate products and capital goods and they will also motivate demands for higher money incomes by local factors of production, especially wage and salary employees.

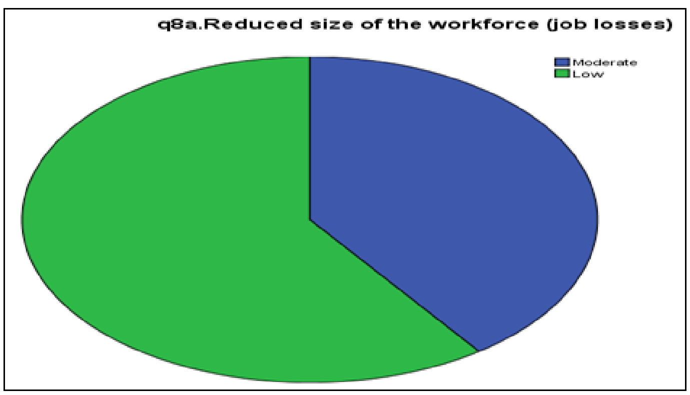


**Fig 2:** q8a.Reduced size of the workforce (job losses)

However, the cycle of wage and price increases should be self-limiting, unless all parties including the government attempt to maintain their real incomes in the face of rising import prices, or unless the devaluation stimulates price increases that are quite unrelated to increases in costs. In addition, for either case the monetary authorities must support the increase in money incomes with domestic credit expansion if domestic prices and incomes are to rise by the full amount of the devaluation without generating unemployment.

**Table 3:** Inflation leading to price rise of goods and services

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Very high | 17 | 34.0 | 34.0 | 34.0 |
| | High | 21 | 42.0 | 42.0 | 76.0 |
| | Moderate | 12 | 24.0 | 24.0 | 100.0 |
| | Total | 50 | 100.0 | 100.0 | |

**Source: primary data**

On inflation which is the sharp rise in prices of goods and services, data in Table 4.2above shows that majority of SMEs surveyed representing 34 percent have agreed strongly that the devaluation of the kwacha by over 50% had caused inflation to increase. They agreed that there was a sharp increase in prices of goods and services from 2012 to 2015 as compared to inflation experienced from stable and strong kwacha regime from 2009 to 2011.

From the above table it could be observed that 21 (42%) of the respondents were of the opinion that devaluation of the kwacha had led to the increase in inflation. Whiles 12 (24%) fairly or moderately agreed that the devaluation of the kwacha had an impact on the sharp increase in prices of goods and services.

From the table above, it can also been observed that majority of the SMEs agreed that the loss of value by the kwacha led to an increase in prices of their goods and services and that their businesses failed to produce and sell more products as compared to times when the currency was stable and appreciated.

Higher inflation Zambian economy is experiencing higher inflation, which will decrease purchasing power of kwacha against other currencies. Zambia is experiencing high inflation above 8% for all most years. If inflation becomes higher, it leads to overall worsening of economic prospects and capital outflows and eventual depreciation of currency.

If inflation is relatively lower than competitors are, then the countries goods will become more attractive and demand will rise. Lower inflation tends to increase the value of the currency in the long term.

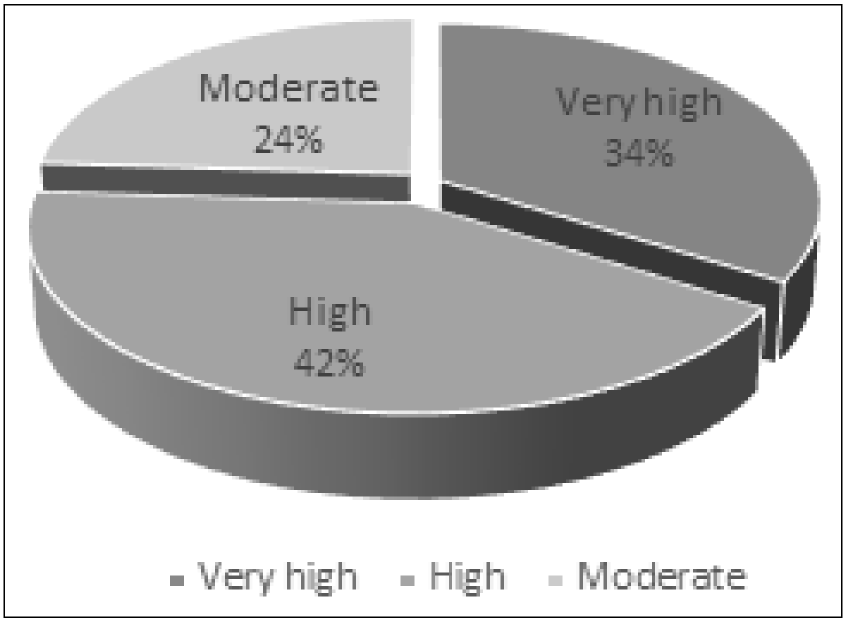


**Fig 3:** Inflation (increase in prices of goods)

**Source: primary data**

The increase in price of goods because of devaluation may decrease the total money in circulation. Devaluation will push the interest rate up wards and decrease the aggregate demand ceteris paribus. Domestic firms that use bank loan for production will also be affected because of the increase in the interest rate. For countries that borrow money and are highly in debt, the increase in interest rate together with devaluation of currency will make situations even worse as the amount will increase.

The depreciating kwacha will bring delight to the exporters as goods exported abroad will bring dollars, which in return will translate, into more kwachas. A sharply declining kwacha activates inflation, broadens the current account deficit, hits investor sentiment and creates burden for the SMEs with high exposure to foreign debt. (Kampamba Shula, 2015) [16]

**Table 4:** Transportation expenses going higher

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Very high | 23 | 46.0 | 46.0 | 46.0 |
| | High | 23 | 46.0 | 46.0 | 92.0 |
| | Moderate | 4 | 8.0 | 8.0 | 100.0 |
| | Total | 50 | 100.0 | 100.0 | |

Source: Primary data

From the results in Table 4.4, it could be observed that the number of SMEs surveyed had experienced an increase in transportation expenses has been analyzed. The results above indicates that 23 (46%) of the total respondents agreed that there has been an increase in transportation cost.

Also 4 (8%) of the total respondents moderately accepted about the increase in transportation costs been incurred by the businesses.

Whilst 23 (46%) of the total respondents claimed they were high costs attached to transportation by their businesses in about last five years.

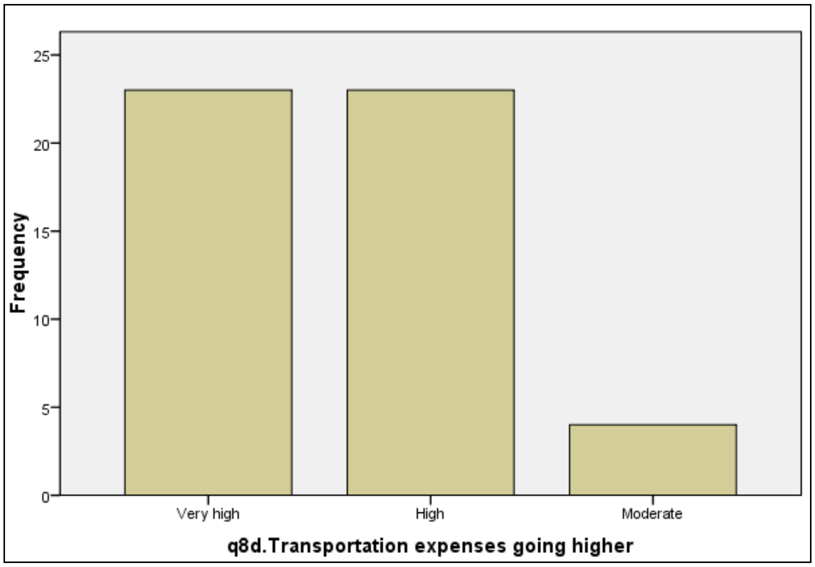


**Fig 4:** q8d. Transportation expenses going higher

**Source: Primary data**

Strong demand of US currency from importers and banks and dollar strength against other currencies overseas amid expectation remains a challenge for importers and retailers. Whether the currency would find its stable level or will continue to slide further remains a complicated question.

Travel expenses rose, as fuel got costlier. Crude oil is priced in dollars, is Zambia's biggest import item and depreciating kwacha increases the cost of imports. The companies depending on imported products as is the case with most SMEs saw a sharp impact on their bottom line. A weak kwacha also exposed these SMEs.

A weak kwacha created extra stress on oil marketing companies (OMC), this was surely passed on the consumers, and customers as the companies allowed doing so after the deregulation of petrol and partial deregulation of diesel. As OMC increased fuel prices, there was a substantial increase in overall cost of transportation, which triggered inflation. (Kampamba Shula, 2015) [16]

**Table 5:** Increased cost of imported raw materials and goods

| | | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|---|
| Valid | Very high | 35 | 70.0 | 70.0 | 70.0 |
| | High | 15 | 30.0 | 30.0 | 100.0 |
| | Total | 50 | 100.0 | 100.0 | |

Source: Primary data

On increased cost of imported goods for resell, data in Table 4.4 above shows that majority of SMEs surveyed representing 35 (70 percent) had highly agreed that the there was an increase in the cost of imported goods for resell. This consequently had decreased or affected their profitability as compared to profit margin earned from periods of stable and appreciated kwacha between 2008 and 2011 during the Movement for Multiparty Democracy (MMD) regime.

From the above table 4a it could be observed that 15 (30%) of the respondents were of the opinion that kwacha depreciation had led to the increase in the cost of imported goods. Whilst 35 (70%) strongly agreed that there was a very high increase to costs of imported goods and they would have made more profit if the kwacha had gained against major currencies like the Euro, Pound and US dollar.

From the table 4b below, it can also been observed that 35 (70%) of the respondents strongly agreed that their businesses suffered from increased cost of imported goods. These SMEs would sell more products if they had stable and reliable kwacha.

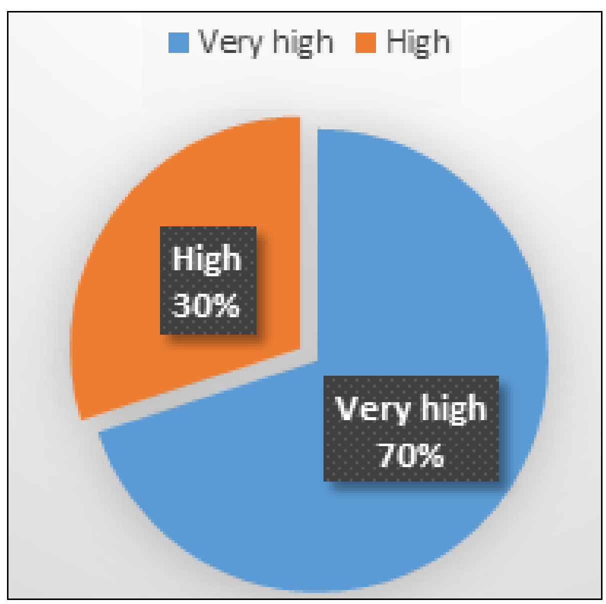


**Fig 5:** Increased cost of imported goods

**Source: primary data**

This is because by assumption imports have already been stringently limited by high tariffs, disadvantageous exchange rates, and quantitative restrictions, all of which create a strong price incentive for domestic production.

As a result, it is difficult to predict whether depreciations will have a positive or negative effect on SMEs that were more profitable before the depreciation. The first part of the analysis focused on how depreciations affect SMEs on average. It finds that in the year after depreciations, firms have significantly higher growth in market capitalization, suggesting that depreciations increase the present value of firms' expected future profits. On the other hand, firms have significantly lower growth in net income measured in local currency, suggesting that even if firms benefit from depreciations in the end, the immediate impact on performance may be negative.

Finally, firms producing traded goods tend to have significantly lower income growth than firms producing non-traded goods, but this result is sensitive to the inclusion of the foreign exposure variables and does not apply for the other performance measures. Although there are a number of factors other than firm characteristics that determine how depreciations affect a country's macro economy, these empirical patterns provide some suggestive evidence of why depreciations can have such varied effects in different countries. The one group of firms that consistently has superior performance after depreciations, whether measured by improvements in sales, net income, market capitalization, or asset value, was firms with greater foreign sales exposure.

Furthermore, any discrepancy between the local-currency value of a dollar's worth of imports and a dollar's worth of exports, for example due to tariffs, means that even a parallel expansion of imports and exports will be deflationary, provided the government does not spend the additional revenue at once.

**Table 6:** Reduced sales by businesses

| | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|---|---|---|---|
| High | 26 | 52.0 | 52.0 | 52.0 |
| Moderate | 24 | 48.0 | 48.0 | 100.0 |
| Total | 50 | 100.0 | 100.0 | |

**Source: Primary Data**

From Table 4.5 above, which represents the respondents who agreed that the average monthly sales of the SMEs sampled had reduced. 26 (52%) of the respondents recorded an average sales reduction due to increased prices of their goods. Most of these goods were imported and with the loss of value of the kwacha against major convertible currencies like the British sterling, the Euro, the USA dollar and the South African rand means most of the goods becoming a bit expensive to the displeasure of the consumers and customers.

SME firms mostly from the Wholesale and Retail trading business, phone accessories and movie and music suffering from customer complaints and a general reduction in sales as citizens are finding it difficult to avoid.

Majority of the respondents experienced limitation in sales and high labour cost and reduced profits.

## Summary of findings

Therefore, relatively open economies with substantial export experience are more likely to benefit from depreciations, while relatively closed economies with limited export capacity are more likely to experience an economic contraction. The observed results, however, did not find evidence of a tough relationship between several other firm characteristics and the impact of depreciations on firm performance.

Some of these estimated relationships may be insignificant because it is not only the firm characteristic that determines the impact of depreciations, but rather the interaction between the firm characteristic and macroeconomic variables such as inflation, interest rates, government spending, or changes in the composition of aggregate income. For example, a model developed in Forbes (2002a) suggests that for commodity firms, it is not just capital and labor in proportion that determines how depreciations affect sales growth, but the interaction between capital/labor ratios and changes in the cost of capital.

Second the devaluation may stimulate price increases that are overdue in any case, but for reasons of inertia were not made earlier. A currency devaluation being little understood by the public, presents an all occasion to 'raise such prices and lay responsibility. Several devaluations have led to rioting and wage increase claims.

Closely related to the impact of depreciations on traded versus non-traded goods is whether firms had foreign sales before the depreciation. Firms with export experience are better positioned to benefit from the relative cost advantage of depreciations (Fundanga, 2009).

Granted, firms that do not have foreign sales exposure before depreciations could begin operating abroad after depreciations, but developing international operations can involve substantial time delay. Therefore, firms with foreign sales would be expected to exhibit better performance directly after depreciations than firms without foreign exposure.

## Conclusion

The relationship between firm profitability and the impact of depreciations of firm performance is also difficult to predict (Shiv Dixit, 2009) [13]. Firms that are more profitable tend to be operated by more capable managers, who could be better able to adjust production to benefit from depreciations. Closely related, if depreciations are followed by an output or sales reduction, then more profitable firms may be better able to survive the reduction in demand, while less profitable firms are more likely to go insolvent.

Possibly working against this effect, however, more profitable firms may be operating closer to full capacity and therefore have fewer excess resources to reallocate and adjust to the depreciation.

Inflation can lead to changes in asset values that do not reflect changes in economic well-being. Therefore, inflation's effects should be removed when measuring real income and economic depreciation. For example, suppose that over the course of a year the general price level doubles. If a SMEs' assets also double in value, he is no better off in terms of the real inflation adjusted purchasing power of his assets than he was at the beginning of the year. He would be better off only if the value of his assets more than doubled. Consequently, purely nominal growth in asset values should not trigger tax liability under a tax system based on economic income. (Ilyas Ahmed, 2011)

Importing products such as fuel and other consumables became very costly. Crude oil, which is priced in dollars, is one of Zambia's biggest import items and depreciating kwacha increased the cost of imports. The companies depending on imported raw materials saw a sharp impact on their bottom line.

A weak kwacha created extra stress on oil marketing companies (OMC) and that was passed on the consumers as the companies allowed doing so after the removal of subsidies and deregulation of petrol and partial deregulation of diesel. If OMC increased fuel prices, there would be a substantial increase in overall cost of production, which triggered inflation.

Travelling abroad become costlier as Zambians were to pay more kwachas to buy dollars for overseas trips. Those who plan to go to China, Dubai or South Africa for business had to spend more amounts due to the sharp fall in Kwacha.

The weakening of kwacha put severe strain on SMEs dealing in components for automobile. As the automobile SMEs were importing components from abroad even from Japan. The consequence was a raised price of automobiles. Kwacha depreciation has had a major impact on aviation sector. In case of airlines the kwacha depreciation had significant impact as their dollar revenue was less while most of their expenses were in dollars.

Kwacha depreciation against US dollars led to an increase in fuel costs, thus resulting in higher costs for transporters. The challenges of logistics end users were primarily since importers needed to pay the transporting charges in US dollars and hence, additional amount had to be paid for the same imported consignments, making international trade less profitable for the SMEs CBD as most of them deal in imported products.

A weak kwacha will increase the burden of Oil Marketing Companies (OMCs) and this will surely be passed on to the consumers as the companies are allowed to do so following deregulation of petrol and partial deregulation of diesel. If the OMCs increase fuel prices, there will be a substantial increase in overall cost of transportation which will stoke up inflation.

Travelling abroad will be costlier as Zambians will have to pay more kwachas to buy Dollars for overseas trips. Those who plan to go to China, Dubai or South Africa for business had to spend more amounts due to the sharp fall in kwacha.

Increased price of fuel increased prices and demand for oil is another reason for the loss of value by the kwacha. Zambia has to import volume of its oil requirements to satisfy its local demand which is increasing every year. The domestic demand for oil is increasing which causes the price of the oil to increase in the international market. The demand for dollar increases as we have to make payments to our suppliers in dollars. This increase in demand for dollar weakens the rupee. 55% of the India's oil import is used for transportation of goods and people and 50%of that or 27% of the total is used for transporting. (Caleb M Fundanga, 2009)

The fall of the Zambian kwacha in comparison to the US dollar has adversely affected the tourist outflow to foreign countries, especially Europe, America and South Asian countries. With cheap airfare rates and lucrative tour packages, there was a big surge in the number of tourists visiting abroad earlier. Now with the kwacha declining steeply against the dollar, people have started to look for shorter trips and destinations within Zambian. The inflow of foreign tourists increases as Zambia will become a much cheaper destination for tourists coming from the US and Europe. Therefore, kwacha depreciation has both positive and negative impacts.

**Recommendations**

For many years, the Zambian Government and other stakeholders had talked about how much Zambia needed to diversify its economy away from copper. Despite a good performance in non-traditional exports over the past decade, copper still accounted for over 70% of Zambia's exports. That statistic alone showed that the diversification policy had failed to live up to its expectations.

Import input costs are high because of other reasons than merely the exchange rate. Zambia can review its import tariffs on inputs and even introduce tax relief for importers of inputs for manufacturing which had a higher return on tradables as the sectoral price indices indicated that the relative return was higher from manufacturing than agriculture. In short, policy should focus more on diversifying into manufacturing while looking for ways to increase productivity in agriculture.

Unless the export base expands the depreciation of the Zambian Kwacha, however moderate was inevitable. As long as policy makers continued to use the exchange rate as a policy instrument to stimulate diversification instead of using better tools, this policy would be an exercise in futility, however moderate.

The continuous depreciation in Kwacha increased inflation of the country. In such situation Bank of Zambia had very less room to cut policy rates. No cut in policy rate added to the borrower's anguish who were eagerly waiting to get rid of high loan regime. The adverse effects of kwacha depreciation were likely to be offset by gains in export performance.

The Bank of Zambia needs to look at alternative measures of quantitative tightening. Raising interest rates and reserve ratios were overused policy instruments, which usually squeezed credit liquidity and make borrowing expensive for most stakeholders. There is another option, its effectiveness was up for debate but it was always worth the try. It was reverse quantitative easing or otherwise known as quantitative tightening. However, this one was specific to the bond market. (Action Aid, 2015)

This meant the Bank of Zambia would trade long-term treasuries for short term treasuries, effectively draining the market of liquidity, without raising the rates. For this to work it would require shortening treasury periods from 3 months to one month to make it more effective. This is by no means guaranteed to be effective but it is a tool at the disposal of the Bank of Zambia.

The higher fiscal deficit has led to speculative attacks on currency. In case of high deficit government may use foreign currency reserve to finance the deficit. This lead to lowering of reserves and if there is speculation of currency, the government may not have adequate reserve to protect the fixed value of currency. This prompts the government to devalue the currency. Though Fiscal deficit have no direct bearing on foreign markets, play a role in crisis.

The Bank of Zambia needs to make a concerted effort to make the foreign exchange market in Zambia more asymmetrical in terms of information and access to foreign exchange flows. The market in its current state has structural imbalances caused by a skewed control by mining companies and a few big traders. Sorting this out would prevent consistent deviations of the Zambian Kwacha from fundamental levels.

The use of currency appreciation as a policy tool for diversification has to stop. If the Kwacha depreciates necessarily, then let it depreciate reasonably. Import input costs are high because of other reasons than merely the exchange rate. Zambia can review its import tariffs on inputs and even introduce tax relief for importers of inputs for manufacturing which has a higher return on tradable as the sectoral price indices indicate that the relative return was higher from manufacturing than agriculture.

In short, policy should focus more on diversifying into manufacturing while looking for ways to increase productivity in agriculture. In such situation, BOZ will have very less room to cut policy rates. No cut in policy rate will add to the borrower's woes that are eagerly waiting to get rid of high loan regime. The adverse effects of rupee depreciation are likely to be offset by gains in export performance. (Source: Action Aid, 2015)

Firms might reduce the cost effect of kwacha depreciation against the US Dollar, by directly trading with Zambian Kwacha and China Yuan (ZMK/YUAN) exchange rate other than by first buying the US Dollar with Zambian kwacha and later use the US Dollar to purchase the Chinese Yuan so as to trade with China (Kampamba Shula, 2015) [16]. The US Dollar could only be used in other transactions that do not involve trade with China. However, avoiding the cost of US Dollar appreciation in the importation of goods in this manner is only achievable if ZMK/YUAN and ZMK/USD did not have a long run relationship with each other. This was because, if the two exchange rates had a long run relationship, they would influence each other and therefore, it would be pointless to trade directly in ZMK/YUAN to avoid the cost effect of ZMK depreciation against the US Dollar.

This meant that increased trade with China and by trading directly with ZMK YUAN, would lead to reduced value of ZMKUSD as the demand for US Dollar would reduce. Therefore, this entitled for government to liberalise the transactions in ZMKYUAN.

Finally, the findings also showed that the ZMKRAND had significant effect on ZMKUSD in the short run. Thus increased trade with South Africa should have contributed to strengthening the ZMK against the USD.

Unless the export base expands the depreciation of the Zambian Kwacha, however fair is inevitable. As long as policy makers continue to use the exchange rate as a policy instrument to stimulate diversification instead of using better tools, this policy will be an exercise in futility, however moderate.

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